



The Florida Senate

Interim Project Report 98-34

September 1998

Committee on Judiciary

Senator Fred R. Dudley, Chairman

IS FLORIDA BECOMING A DEBTOR'S HAVEN? A REVIEW OF LAW ON EXEMPTIONS FROM CREDITORS' REMEDIES

SUMMARY

There is a perception that Florida is a debtors' haven. It is uncertain whether this is true. No data could be found on the number of cases in which the homestead exemption was used to defraud the debtor's creditors. Anecdotal information provided by two bankruptcy court trustees did indicate that the problem is limited to a small number of cases. What is certain, however, is that it is possible for the homestead exemption to be used fraudulently under current law. It is recommended that the Florida Constitution be amended to avoid this fraud against creditors. While this remedy may effect only a small number of cases, it may nonetheless have a significant economic impact on the debtors and creditors involved in those cases.

BACKGROUND

There is a perception that Florida is, or is becoming, a debtors' haven. The thought is that debtors living in other states liquidate their property and move to Florida, where they purchase a homestead in order to use Florida's constitutional homestead exemption in bankruptcy court to avoid the collection efforts of their creditors. For the last several years, there have been bills aimed at limiting this homestead exemption. In the 1998 Regular Session, there was a bill that proposed amending the constitution to limit the homestead exemption by providing that it does not apply to any property to the extent that the homestead is acquired or the equity value of the homestead is increased through the prepayment of any mortgage debt with the intent to hinder, delay, or defraud the creditors of the owners. None of these bills passed.

The President directed staff of the Senate Committee on Judiciary to determine whether legislation is needed to overcome the perception of Florida as a debtors' haven.

METHODOLOGY

Staff of the Senate Committee on Judiciary reviewed relevant statutes and case law relating to: the Federal Bankruptcy Code; the homestead exemption contained in section 4, Article X of the Florida Constitution; the Florida Statutes on the homestead exemption, ss. 222.01, 222.02, 222.03, 222.04, 222.05, 222.08, 222.09, and 222.10, F.S.; and the Florida Statutes relating to fraudulent transfers, ss. 222.29, and 222.30, F.S. and ch. 726, F.S. Staff also solicited information from organizations whose members may have experience with debt collection and application of the exemptions, including: Floridians for Fair Debt Exemptions, the Business Law Section of The Florida Bar, the Florida Bankers Association, the Florida Retail Federation, the Florida Chamber of Commerce, Associated Industries of Florida, NationsBank Corporation, Citibank/Citicorp, and Mark Freund, a bankruptcy trustee.

FINDINGS

A. Perception of Debtors' Haven Hinges on Homestead Exemption

For the last few years, there has been a perception that Florida is a debtors' haven, as evidenced by periodic newspaper articles. The focus of these articles is typically on debtors from other states liquidating their assets in those states, moving to Florida and buying an expensive home, then filing for bankruptcy and using the homestead exemption to avoid their creditors' attempts at collection. It is possible for this to occur under current law, as is discussed below.

B. Relevant Provisions in the Federal Bankruptcy Code, the Florida Constitution, and the Florida Statutes

1. Which Exemption Law Applies, Federal or Florida?

Although federal law controls in bankruptcy proceedings, the Bankruptcy Code allows each state to “opt out” of the Code’s exemption provisions. 11 U.S.C. s. 522(b). When a state chooses to opt out of the Code’s exemptions, that state’s law on exemptions from creditors’ collection actions applies instead. Florida has opted out of the federal exemptions. s. 222.20, F.S. As such, the Florida exemption law applies in bankruptcy cases, including Florida law on the homestead exemption.

2. Florida Constitution Provisions on Homestead Exemption

The Florida Constitution provides an exemption from forced sale or lien for homestead property. s. 4, Art. X, Fla. Const. “Homestead” property must be owned by a natural person and includes:

- If located outside a municipality, one hundred sixty acres of contiguous land and improvements thereon, which cannot be reduced without the owner’s consent by reason of subsequent inclusion in a municipality; or,
- If located within a municipality, one-half acre of contiguous land, upon which the exemption shall be limited to the residence of the owner or his family.

Id.

There are express exceptions to the exemption, including liens or forced sale for the payment of taxes and assessments thereon, obligations contracted for the purchase, improvement or repair thereof, or obligations contracted for house, field, or other labor performed on the realty. *Id.* The exemption passes to the surviving spouse or heirs of the owner. *Id.*

3. Florida Statutes Provisions on Homestead Exemption

The Florida Statutes relating to the homestead exemption are contained in chapter 222, F.S. These statutes provide for the method of designating property as exempt homestead and provide for jurisdiction for any disputes concerning the exemption. A person may designate real property, a mobile home, or a modular

home as homestead property exempt from forced sale either before or after levy on the property. ss. 222.01 and 222.02, F.S. This includes a designation of homestead by any person owning and occupying any dwelling house, including a mobile home used as a residence, or a modular home, on land not his or her own which he or she may lawfully possess, by lease or otherwise. s. 222.05, F.S. A person may designate homestead property before levy by making a written statement containing a description of the real property, mobile home, or modular home claimed to be exempt and declaring that the real property, mobile home, or modular home is the person’s homestead. s. 222.01, F.S. The statement must be signed by the person making it and must be recorded in the circuit court. *Id.* A person may designate homestead property after levy by notice under oath made before any officer of this state duly authorized to administer oaths, at any time before the day appointed for the sale thereof, of what that person regards as his or her homestead and a description thereof. s. 222.02, F.S. Upon such notice, only the remainder of any property subject to the levy is subject to sale under such levy. *Id.*

If the creditor in any execution or process sought to be levied is dissatisfied with the quantity of land selected as homestead, the creditor may notify the officer levying the property and have the officer to cause the property to be surveyed. s. 222.03, F.S. Upon a survey indicating that the amount of property claimed as homestead is incorrect, the amount of property claimed is to be increased or decreased, as appropriate, based on the survey. *Id.* After any requested survey has been made, the officer making the levy may sell the property levied upon which is not included in homestead property. s. 222.04, F.S.

Chapter 222, F.S., gives jurisdiction over exemption claims to the circuit courts. The circuit courts have equity jurisdiction to order and decree the setting apart of homesteads and of exemptions of personal property from forced sales. s. 222.08, F.S. They also have equity jurisdiction to enjoin the sale of all property, real and personal, that is exempt from forced sale. s. 222.09, F.S. Finally, they have equity jurisdiction to determine whether any property claimed to be exempt is so exempt, and if the property is not exempt, to subject the property, or so much of the property as may be necessary, to the satisfaction of a judgment or decree, and may enjoin the sheriff or other officer from setting apart as exempt property that which is not exempt. s. 222.10, F.S.

4. Provisions on Fraudulent Transfers and Fraudulent Conversions

a. Chapter 222 of the Florida Statutes

Chapter 222, F.S., also provides for fraudulent transfers and fraudulent asset conversions. No exemption from attachment, garnishment, or legal process provided by ch. 222, F.S., is effective if it results from a fraudulent transfer or conveyance as provided in ch. 726, F.S. s. 222.29, F.S. Chapter 726, F.S., provides for avoidance of fraudulent transfers in general. Additionally, s. 222.30, F.S., provides that any conversion of an asset by a debtor that results in the proceeds of the asset becoming exempt by law from the claims of a creditor of the debtor is a fraudulent asset conversion as to the creditor, whether the creditor's claim to the asset arose before or after the conversion of the asset, if the debtor made the conversion with the intent to hinder, delay, or defraud the creditor. s. 222.30, F.S.

In an action for relief against a fraudulent asset conversion, a creditor may obtain avoidance of the fraudulent asset conversion to the extent necessary to satisfy the creditor's claim, an attachment or other provisional remedy against the asset converted in accordance with applicable law, or, subject to applicable principles of equity and in accordance with applicable rules of civil procedure, an injunction against further conversion by the debtor of the asset or of other property or any other relief the circumstances may require. s. 222.30, F.S. If a creditor has obtained a judgment on a claim against the debtor, the creditor, if the court so orders, may levy execution on the asset converted or its proceeds. *Id.* A cause of action with respect to a fraudulent asset conversion is extinguished unless an action is brought within 4 years after the fraudulent asset conversion was made. *Id.* If an asset is converted and the converted asset is subsequently transferred to a third party, the provisions of ch. 726, F.S., apply to the transfer to the third party. *Id.*

b. Chapter 726 of the Florida Statutes

Chapter 726, F.S., provides for avoidance of fraudulent transfers in general, not just for transfers involving homestead property. Section 726.105, F.S., provides that a transfer made or obligation incurred by a debtor is fraudulent as to a creditor, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation:

- With actual intent to hinder, delay, or defraud any creditor of the debtor; or
- Without receiving a reasonably equivalent value in exchange for the transfer or obligation, and the debtor:
 - Was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction; or
 - Intended to incur, or believed or reasonably should have believed that he or she would incur, debts beyond his or her ability to pay as they became due.

Section 726.105, F.S., also provides that in determining actual intent, consideration may be given, among other factors, to whether:

- The transfer or obligation was to an insider.
- The debtor retained possession or control of the property transferred after the transfer.
- The transfer or obligation was disclosed or concealed.
- Before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit.
- The transfer was of substantially all the debtor's assets.
- The debtor absconded.
- The debtor removed or concealed assets.
- The value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred.
- The debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred.
- The transfer occurred shortly before or shortly after a substantial debt was incurred.
- The debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the debtor.

Section 726.106, F.S., provides that a transfer made or obligation incurred by a debtor is fraudulent as to a creditor whose claim arose before the transfer was made or the obligation was incurred if the debtor made the transfer or incurred the obligation without receiving a reasonably equivalent value in exchange for the transfer or obligation and the debtor was insolvent at that time or the debtor became insolvent as a result of the transfer or obligation. The section also provides that a transfer made by a debtor is fraudulent

as to a creditor whose claim arose before the transfer was made if the transfer was made to an insider for an antecedent debt, the debtor was insolvent at that time, and the insider had reasonable cause to believe that the debtor was insolvent.

Section 726.108, F.S., provides for creditors' remedies for fraudulent transfers. The section provides that a creditor bringing an action for relief under ch. 726, F.S., may obtain:

- Avoidance of the transfer or obligation to the extent necessary to satisfy the creditor's claim;
- An attachment or other provisional remedy against the asset transferred or other property of the transferee in accordance with applicable law;
- Subject to applicable principles of equity and in accordance with applicable rules of civil procedure:
 - An injunction against further disposition by the debtor or a transferee, or both, of the asset transferred or of other property;
 - Appointment of a receiver to take charge of the asset transferred or of other property of the transferee; or
 - Any other relief the circumstances may require.

Additionally, if a creditor has obtained a judgment on a claim against the debtor, the creditor, if the court so orders, may levy execution on the asset transferred or its proceeds.

c. Federal Bankruptcy Code

The Federal Bankruptcy Code also provides for avoidance of fraudulent transfers. 11 U.S.C. s. 548. The Code provides, in part, that the bankruptcy trustee may avoid any transfer of a property interest of the debtor that was made on or within one year before the date of the filing of the petition for bankruptcy, if the debtor voluntarily or involuntarily made the transfer *with actual intent to hinder, delay, or defraud* any entity to which the debtor was or became indebted on or after the date that such transfer was made. *Id.*

C. Case Law

1. Application of Florida Fraudulent Transfer/Conveyance Statutes to the Homestead Exemption

One court has held that s. 222.29, F.S., which states that an exemption from creditors' remedies is not effective if the remedy results from a fraudulent

transfer or conveyance, is not applicable to the homestead exemption. *In re Clements*, 194 B.R. 923, 925 (Bkrcty.M.D.Fla. 1996). The court concluded that the statute is inapplicable to homestead for two reasons. *Id.* First, the statute expressly applies to exemptions provided by ch. 222, F.S., and homestead is provided by the constitution. *Id.* Second, the Legislature cannot by statute impair rights given by the constitution; it would take a constitutional amendment to restrict the homestead exemption right. *Id.* Although no case was found attempting to apply ch. 726, F.S., to a claim of a homestead exemption, the *Clements* rationale would surely apply to these statutes as well.

2. "Equitable Lien" vs. Homestead Exemption

As early as 1912, the Florida Supreme Court stated that:

Organic and statutory provisions relating to homestead exemptions should be liberally construed in the interest of the family home. But the law should not be so applied as to make it an instrument of fraud or imposition upon creditors.

Milton v. Milton, 58 So. 718 (Fla. 1912).

In 1925, the Florida Supreme Court first held that an equitable lien existed on and could be enforced against homestead property, due to the acts of the debtor to avoid payment to creditors. *Jones v. Carpenter*, 106 So. 127 (Fla. 1925). In this case, the Court summarized the facts, the "considerations of right and justice supporting the claim for equitable lien," as follows:

The record shows that appellant brought this suit in behalf of the creditors of the Jacksonville Bread Company, a bankrupt corporation; that in October and November, 1920, appellee being its president took from the funds of said corporation the aggregate sum of \$535.84, more specifically referred to elsewhere in this opinion, and used the same to pay for labor and materials to improve his home; that he did in fact make substantial improvements on his home with said funds; that in less than two months after said funds were withdrawn, petition in bankruptcy was filed against said corporation, and on July 5, 1921, it was adjudicated a bankrupt; that appellee is insolvent, and judgment against him would be worthless; and that he now refuses to replace said funds or pay same into the bankrupt estate or any part thereof and defends against such payment on the ground

that said funds have become a part of his homestead.

Id. at 129.

The Court stated that the facts of the case constituted “an injustice and hardship on creditors that the homestead exemption should not be extended to, and we think appellee must make restitution.” *Id.* at 130. The Court further stated that the homestead exemption cannot be used as a shield after fraudulently imposing on others. *Id.*

The Court has since held in three other cases that an equitable lien could be applied against homestead property. In the first case, money was advanced for use to improve the real property of another, with an ambiguous verbal agreement that the persons advancing the money would obtain an interest in the real property, however no interest was ever conveyed. *La Mar v. Lechliden*, 185 So. 833 (Fla. 1939). No fraud was established in this case. *Id.* at 836. Instead, the holding was based on the unjust enrichment which would otherwise result to the defendant because the plaintiffs innocently, with the belief that they had the right to do so, and with the consent of the defendants placed permanent and valuable improvements on the defendant's land. *Id.*

In the second case, the plaintiff advanced money to the defendant and worked for him without compensation over a number of years based on an agreement that defendant would care for plaintiff for the rest of plaintiff's life, an agreement which was not kept. *Sonneman v. Tuszynski*, 191 So. 18 (Fla. 1939). The holding was based on a special equity in the defendant's real property as plaintiff's monetary advances and labor had increased the value of that property. *Id.*

In the third case, despite the fact that plaintiff bank knew that defendant and her husband were involved in dissolution of marriage proceedings at the time, it loaned money to defendant's husband, secured by a mortgage on the marital home, and permitted the husband to obtain defendant's signature without requiring her to sign in the bank's presence, with the result that he forged her signature. *Palm Beach Savings and Loan Association, F.S.A. v. Fishbein*, 619 So.2d 267 (Fla. 1993). In the subsequent foreclosure action, the trial court held that the defendant had not abandoned her homestead interest and that the mortgage could not be foreclosed against the house. *Id.* at 269. However, the trial court held that the bank had

an equitable lien on the house to the extent that the loan proceeds were used to satisfy preexisting mortgages and taxes. *Id.* The Supreme Court overturned an appellate decision and affirmed the trial court, saying that to do otherwise would provide to the defendant a windfall to which she was not entitled. *Id.* at 271. The Court further stated that the homestead exemption is intended to be a shield, not a sword. *Id.*

The burden in such cases is on the party seeking the lien and the Florida Supreme Court has stated that “we must assume that the debtor is honest unless and until the contrary is established.” *Slatcoff v. Dezen*, 76 So.2d 792, 793 (Fla. 1954).

3. Forfeiture Statutes and the Homestead Exemption

The Florida Supreme Court has held that the constitutional homestead exemption prohibits forfeiture under the Florida Racketeer Influenced and Corrupt Organization Act of homestead property in which criminal acts took place. *Butterworth v. Caggiano*, 605 So.2d 56 (Fla 1992). Similarly, the Court has also held that the exemption prohibits forfeiture under the Florida Contraband Forfeiture Act of a homestead purchased with the proceeds from criminal acts. *Tramel v. Stewart*, 697 So.2d 821 (Fla. 1997). In both cases, the governmental entity seeking the forfeiture raised the line of cases discussed above as an argument that forfeiture should be allowed despite the exemption. *Caggiano*, at 60-61 n. 5 and *Tramel*, at 823.

The argument was that in those cases the Court had refused to allow the owner of homestead property who committed fraud or reprehensible conduct to shield their actions with the homestead exemption and that the Court should do the same in these cases due to the defendants' criminal acts. *Id.* The Court refused to do so in both cases. *Id.* In *Caggiano* the Court stated that:

Virtually all of the relevant cases involve situations that fell within one of the three stated exceptions to the homestead provision. Most of those cases involve equitable liens that were imposed where proceeds from fraud or reprehensible conduct were used to invest in, purchase, or improve the homestead.

Caggiano, at 60-61 n. 5.

In *Tramel*, the Court quoted its *Caggiano* discussion of these cases and stated:

The constitutional protection of homesteads has not changed since our decision in *Caggiano* to include forfeiture as one of the enumerated exceptions. In the absence of such a provision, this court cannot judicially create one. *Id.* at 60-61.

Certainly, there are compelling reasons to support the forfeiture of homestead property "acquired or improved" with funds obtained through felonious criminal activity or homestead property used in the commission of felonious criminal activity. As well, the homestead protection should not be used to shield fraud or reprehensible conduct. See *Jones v. Carpenter*, 90 Fla. 407, 106 So. 127 (1925). However, to permit the State to forfeit a homestead based upon this criminal activity in Florida requires a constitutional revision. We call this to the attention of the Constitutional Revision Commission.

Tramel, at 823.

4. Homestead Exemption in Bankruptcy

With few exceptions, the bankruptcy courts hold that when non-exempt assets are converted to exempt homestead assets, the exemption cannot be infringed, even where the intent behind the conversion of assets was to delay, hinder, or defraud creditors. *Bank Leumi Trust Company of New York v. Lang*, 898 F.Supp. 883 (S.D.Fla. 1995); *In re Popek*, 188 B.R. 701 (Bkrcty.S.D.Fla. 1995); *In re Lane*, 190 B.R. 125 (Bkrcty.S.D.Fla. 1995); and *In re Clements*, 194 B.R. 923 (Bkrcty.M.D.Fla. 1996). These cases are based on the rationale of *Caggiano*, sometimes citing to that case, that the constitutional exceptions to the homestead exemption must be liberally construed and if the facts of a case do not fall within one of these exceptions, the court cannot deny the use of the homestead exemption. *E.g.*, *Bank Leumi*, at 887. The Courts also follow the *Caggiano* rationale that the equitable lien cases fall within the constitutional exception of obligations contracted for the purchase, improvement or repair of the homestead property. *E.g.*, *Bank Leumi*, at 888.

D. Bankruptcy Trustee Information

Mark Freund has been a Chapter 7 trustee in the Northern District of Florida for eight years. During a telephone conversation, he stated that he does not think Florida is becoming a debtors haven. Telephone

interview with Mark Freund (July 30, 1998). He added that 95-99% of those who file bankruptcy in Florida do not do so to take advantage of Florida's exemption law. *Id.* In a letter, he elaborated on this subject. (Letter from Mark Freund to Jules S. Cohen (August 17, 1988) (discussing a proposed amendment to the constitutional homestead to except acquisition or improvement by fraud). He stated that while he could not say that the practice of a debtor attempting to defraud his creditors by acquiring or improving homestead was common, he could say that when it does occur, "the practice is egregious because it typically involves a wealthy or professional person who has been advised by legal counsel or others to make the debtor's assets unreachable by creditors." *Id.* He stated that he had seen an average of one case per year for eight years in which he could definitively say that the debtor had used the homestead exemption to defraud creditors. *Id.* He noted that one case per year out of an average of 800 cases per year assigned to him as trustee was obviously a small number of cases of fraudulent use of homestead. *Id.* He emphasized that the practice was nonetheless egregious because these cases "typically involve the very wealthy or professional persons whose economic circumstances, even when confronting bankruptcy, is [sic] substantially better than those of the average Florida citizen." *Id.* He set out some of the details of three of his recent cases in which the debtor either obtained money from another or liquidated an asset and used the money to reduce an outstanding mortgage, improve homestead property, or acquire homestead property. In each case, the exemption was allowed to stand. *Id.*

Gordon P. Jones has been a Chapter 7 bankruptcy trustee in the Northern District of Florida for six years. (Letter from Gordon P. Jones to Jules S. Cohen (August 19, 1988) (discussing a proposed amendment to the constitutional homestead to except acquisition or improvement by fraud). He estimated that during this time his annual caseload included, on average, five to ten cases involving acquisition of homestead property, which usually had a significant value; twenty plus cases involving improvements to homestead property, usually in the \$5,000-10,000 range; and, 12 cases involving the reduction of the mortgage. *Id.* He stated that he believed that an amendment to the Florida Constitution to prevent fraudulent use of the homestead exemption was "a good idea even if it prevented only one case per year from manipulating the system." *Id.* He added that without such an amendment, "debtors are encouraged to use the homestead as a vehicle for fraud." *Id.*

RECOMMENDATIONS

It is uncertain whether Florida is or is becoming a debtors' haven. No data could be found on the numbers of cases in which the homestead exemption was used to defraud the debtor's creditors. Anecdotal information provided by two bankruptcy court trustees indicates that the problem is limited to a small number of cases. Even the more indirect evidence such as the number of bankruptcy filings in Florida compared to those elsewhere is inconclusive. There is some evidence that the number of bankruptcy filings in Florida increased from 1984 to 1996 at a rate more than two and a half times the national rate. Floridians for Fair Debt Exemptions, *Florida's Constitutional Homestead Exemption*, September 1998, at 1. However, more recent figures indicate that the percentage growth in bankruptcy filings in Florida from 1994 to 1997 is less than the national average. Hausman, *Some Good News, Some Bad News*, Wall St. J., July 29, 1998.

What is certain, however, is that it is possible for the homestead exemption to be used fraudulently under current law. It is recommended that the Florida Constitution be amended to avoid this fraud against creditors. While this remedy may effect only a small number of cases, both in bankruptcy and collection cases, it may nonetheless have a significant economic impact on the debtors and creditors involved in those cases.

More specifically, it is recommended that the bill which was filed in the 1998 Regular Session be filed again in the 1999 Regular Session *with some modifications*. The first modification is to include the amendment made by the Senate Committee on Judiciary. This amendment took out the language concerning intent to hinder or delay creditors, leaving a proposal to amend the constitution to limit the homestead exemption by providing that it does not apply to any homestead property to the extent that the property is acquired or improved, or the equity value of the property is increased through the prepayment of any mortgage debt, with the intent to defraud creditors. The words "as provided by general law" should be added to this proposal. This would keep the constitutional language more general in nature with the details in statute. This allows the Legislature to respond to any problems uncovered by the courts much more quickly than if all the details were in the Florida Constitution.

COMMITTEE(S) INVOLVED IN REPORT (*Contact first committee for more information.*)

Committee on Judiciary, 404 South Monroe Street, Tallahassee, FL 32399-1100, (850) 487-5198 SunCom 277-5198

MEMBER OVERSIGHT

Senators Tom Rossin and Charles Williams